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FM AMEMBASSY KYIV  
TO RUEHC/SECSTATE WASHDC 4407  
INFO RHEBAAA/DEPARTMENT OF ENERGY WASHINGTON DC  
RUEHZG/NATO EU COLLECTIVE  
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UNCLAS SECTION 01 OF 02 KYIV 002892

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SUBJECT: UKRAINE: DNIPROENERGO - AN EXAMPLE OF INTRANSPARENCY  
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¶1. (SBU) Summary. Rinat Akhmetov, Ukraine's richest man and a key financial sponsor of the Party of Regions, recently acquired 40 percent ownership in financially troubled Dniproenergo, a large power generation company, through a controversial share issuance. Most observers believe that Akhmetov got the stake at far below its true value. Both President Yushchenko and Yuliya Tymoshenko criticized the handling of the privatization, with Tymoshenko assuring voters prior to the recent elections that she would return Dniproenergo to state ownership should she become prime minister. Later, however, she said she would let the courts decide the fate of the deal. Prime Minister Yanukovich has defended the deal. The transaction is unfortunately yet another example of problems besetting Ukraine's deeply flawed privatization policy, yet it may have a silver lining. Widespread critical media coverage suggests that more transparency might raise the risks of such transactions and hence make them more unlikely in the future. Tymoshenko's willingness to refer the deal to the courts might indicate that she might have learned from the re-privatization mistakes committed during her last stint as Prime Minister in 2005. End summary.

#### Dniproenergo's History of Financial Woes

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¶2. (U) Dniproenergo, headquartered in the Zaporizhya Region, is Ukraine's second largest thermal power generation company. Like many companies in the energy sector, it has a history of financial problems. In 2001, an economic court of the Zaporizhya region initiated bankruptcy procedures against Dniproenergo. The same court, in September 2003, recognized \$275 million of debt to 65 companies and organizations. The court also appointed a financial restructuring manager for Dniproenergo. According to the local press, the present restructuring manager is a former board member of a coal mine owned by Donbass Fuel Energy Company (DTEK), the energy arm of Akhmetov's System Capital Management holding company.

#### Dniproenergo Share Issuance

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¶3. (SBU) In late August 2007, representatives of the state's interest in Dniproenergo agreed to issue a 52 percent increase in share capital to avoid bankruptcy. According to Ukrainian press, the only company effectively allowed to purchase these shares was DTEK, one of Dniproenergo's largest creditors. Press reports indicate that a debt-for-equity deal was reached in which DTEK agreed to cover \$200 million of debt to creditors, mostly state enterprises, in exchange for additional equity that increased DTEK's stake in the company from 9 to approximately 40 percent. In addition, DTEK pledged to invest \$200 million to upgrade capacity over the next five years. However, the pledge does not appear to be legally binding. The market value of the company is currently

estimated at between \$1.5 and \$2.2 billion. Analysts thus believe that DTEK purchased its shares at a substantial discount to the market price.

#### Deal Expands Akhmetov's Interests, Dilutes Others

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¶4. (SBU) Akhmetov, by all accounts Ukraine's richest citizen, is a member of parliament and the primary financial sponsor of the Party of Regions. With his companies already managing VostokEnergo, a thermal power generating company in Donetsk, the additional investment in Dniproenergo gives Akhmetov strong influence over almost half of the country's thermally generated power. The share issuance reduced the state's stake in Dniproenergo from 76 to 50 percent plus one share. The remainder belongs to minority shareholders whose stakes have been reduced from 15 to 10 percent. According to press reports, foreign investors who saw their holdings shrink are angry and claim that the transaction could damage Ukraine's investment climate. However, while the minority stakeholders could file suit, most reportedly are expected to take advantage of a share buyback scheme on offer or hold onto their reduced stakes in hopes that the share price will continue to increase.

#### Yushchenko and Tymoshenko Criticize Deal

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¶5. (U) Yushchenko criticized Yanukovych's handling of the privatization and issued a decree in early August ordering the government to prevent asset stripping of state-controlled energy companies by imposing a ban on share capital dilutions. He also took measures to prevent the planned privatizations of several other companies. (Note: under Ukrainian law the President's decree was not binding, as the authority to ban share capital dilutions belongs to the Cabinet of Ministers. End note). Yuliya Tymoshenko took the

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issue a step further. As part of a broader attack on what she described as the current government's policy of enriching its allies, Tymoshenko sharply criticized Yanukovych and Akhmetov and alleged that the deal had been fixed. In a letter to the Korrespondent newspaper, she claimed the Dniproenergo sell-off represented a classic scheme in which a company is forced into bankruptcy and subsequently rescued by a kind creditor who, in reality, facilitated the forced bankruptcy in order to gain control of the company. She also asserted that the company had been undervalued and that Akhmetov could now move to control the energy sector and increase electricity prices significantly.

¶6. (SBU) Most commentators now believe that the reprivatization policy during Tymoshenko's eight-month term as prime minister in 2005 was poorly managed and damaging to the investment climate, despite her success in reprivatizing Kryvorizhstal. (Note: Kryvorizhstal was sold to Akhmetov and fellow oligarch Viktor Pynchuk for \$800 million in 2004 just before then-President Kuchma left office. Tymoshenko retook control of the company when she came to power and subsequently sold it to steel magnate Lakshmi Mittal for \$4.8 billion in an open and transparent tender. End note.) Prior to the pre-term September 2007 elections, Tymoshenko declared that companies such as Dniproenergo that had been "stolen" through shadowy privatizations would be returned to the state. She subsequently clarified in a newspaper interview that such disputes would be resolved in the courts and said that lawsuits had already been filed to stop the Dniproenergo acquisition.

#### Yanukovych Defends Deal, Criticizes Tymoshenko

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¶7. (SBU) Yanukovych has defended the acquisition as a way of improving Dniproenergo's financial position. Some analysts agree that greater private ownership could improve management, eventually raising share prices. In addition, Yanukovych's supporters responded to the attacks by drawing attention to controversial deals made by the government during Tymoshenko's term as prime minister, and to her own alleged ties to big business.

18. (SBU) The Dniproenergo case is not an isolated one, as Ukraine's history is marred with non-transparent privatizations that have benefited a few well-connected insiders. The fate of Dniproenergo will depend on whichever political constellation forms a government.

It seems fair to assume the deal is unlikely to be questioned as long as PM Yanukovich remains in power. An Orange government might question the privatization, yet it now appears that Tymoshenko, should she become PM, will allow the courts to decide the legitimacy of the deal.

The Dniproenergo deal may have a silver lining. Minutiae of the deal have been widely reported and analyzed in the media, with nearly all commentators arguing that Akhmetov got his share on the cheap. Such vigorous reporting is an indication that it is becoming more difficult to pull off shady deals without Ukrainian society taking notice. More transparency could raise the costs and risks of such transactions and hence reduce their likelihood in the future. In addition, Tymoshenko's willingness to refer the deal to the courts might indicate that her campaign threats were only rhetoric, and that she might have learned from the re-privatization mistakes committed during her last stint as Prime Minister. End comment.

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